MAMOR SDN. BHD. v. DIRECTOR-GENERAL OF INLAND REVENUE

[A.C.J. (Anuar J.) November 29, 1979]

[Johore Bahru — Tax Appeal No. 1 of 1977]

Revenue Law — Income Tax — Whether sums received from extraction and sale of timber from land were chargeable to income tax, development tax and timber profit tax.

Practice and Procedure — Finding of facts by Special Commissioner — Review powers of High Court — When High Court will interfere.

This was an appeal by way of case stated from a decision of the Special Commissioners of Income Tax. The appellant company was incorporated in 1968 and its objects among other things were to carry on the business of planters and cultivators of and dealers in all kinds and descriptions of produce and to carry on business as timber merchants, sawmill proprietors etc. In 1968 the State Government contemplated a scheme to alienate state land to the private sector for development. Successful applicants would be given 7,000 acres for development of oil palm. The applicants would be required to surrender 1,500 acres from the 7,000 acres when they were fully planted with oil palm to the Johor State Development Corporation. The applicant was one of the successful applicants and was allotted a parcel of virgin jungle comprising an area of approximately 7,000 acres in the district of Kluang for development into oil palm plantation subject to payment of various charges and to certain terms and conditions as stipulated in the notice. As one of the terms and conditions was that the appellant would be given the right to extract timber from the land, the appellant was required to enter into an agreement with the State Government with regard to the extraction of timber from the land. The appellant was given a logging licence in April 1970 and commenced logging operation on July 20, 1970. The Special Commissioners found that during the relevant basis periods in respect of which assessment of income tax, timber profit tax and development tax were made only two blocks of 1,000 acres each were exploited. Each block was divided into sub-blocks of 250 acres each. The appellant cleared 1,000 acres in September 1971 and a second 1,000 acres in September 1972. Having had no experience in timber marketing they appointed the Pan-Singapore Timber Enterprise Company of Singapore as their agent to find buyers. The appellant received the price of the sale less transport charges, export duties and related expenses. The question for determination by the Commissioners was "Whether the sums received by the appellant from the extraction and sale of timber from the said land for the relevant basis periods were sums received in the course of development of the said land into an oil palm plantation and were capital receipts and not income from a separate business of timber operators carried on by the appellant, and were, on the other hand, income chargeable to income tax, development tax and timber profit tax." They came to the finding that (a) the sums received from the extraction and sale of timber from the said land for the relevant basis periods were income chargeable to income tax, development tax and profits tax; (b) there were two separate and distinct activities, viz. the extraction and sale of timber from the said land and the development of the land into an oil palm estate. Such extraction and sale of the said timber constituted the carrying on of a business of timber operators under section 4(a) of Income Tax, 1967. Therefore the sums received from the extraction and sale of the said timber for the relevant basis periods were income chargeable to income tax, development tax and timber profits tax. It had been argued that the deciding order of the Special Commissioners was entirely based on findings of facts and as such the court could not interfere with the decision made on such findings by the Special Commissioners.

Held: (1) in the circumstances of the facts as found by the Special Commissioners and drawing the reasonable inferences from them the extraction and sale of timber and the development of the land into oil palm were one activity for the purpose of tax. The sum received by the appellant from the extraction and sale of timber from the said land for the relevant basis periods were sums received in the course of development of the said land into an oil palm and therefore were not chargeable to income tax, development tax and timber profit tax;

(2) it was open for the High Court to review the decision of the Special Commissioners, if the Special Commissioners (a) misdirect themselves on the law; or (b) answer the wrong question; (c) omit to answer a question which they ought to have answered; (d) took into account factors which they ought not to have; (e) reached a conclusion on facts which is not supported by the evidence before them; and (f) made a finding of facts which no reasonable person in the circumstances would have arrived at;

(3) the High Court has power to interfere with inferences drawn by the Special Commissioners whether they be conclusions of fact or law;

(4) the object clauses in a company's Memorandum of Association themselves are not to be taken as conclusive proof as to the nature of business carried on by the taxpayer;

(5) the language used by the parties to a document is not the determining factor. It is the duty of the court to see what in substance, and in truth, the bargain was and not to be blinded by some formula which the parties may have used.

Cases referred to:-

(1) *M.Y.* v. *Comptroller of Inland Revenue* [1972] 2 M.L.J. 110.

(2) *N.Y.F. Realty Sdn. Bhd.* v. *Comptroller of Inland Revenue* [1974] 1 M.L.J. 182.

(3) *Re Hydnland Investment Co. Ltd.* 14 T.C. 694.

(4) *E.* v. *Comptroller of Inland Revenue* [1970] 2 M.L.J. 117.

(5) *Henley* v. *Murray* [1950] 1 All E.R. 908.

(6) *Commissioner of Taxes* v. *British Australian Wool Realization Association, Ltd.* [1931] A.C. 224.

(7) *Rand* v. *Alberni Land Co. Ltd.* 7 T.C. 629.

(8) *Van Den Berghs, Ltd.* v. *Clark* 19 T.C. 390 @ pp. 428 & 429.

(9) *Cape Brady Syndicate* v. *I.R.C.* [1921] 1 K.B. 64.

TAX APPEAL.

Michael Wong (*C.V. Das* with him) for the appellant.

Abdul Razak bin Ibrahim (Senior Federal Counsel) for the respondent.

Cur. Adv. Vult.

Anuar J.: This is an appeal by way of case stated from a decision of the Special Commissioners of Income Tax confirming the assessment of Income Tax made upon the appellant for the years 1971, 1972 and 1973.

The question for determination by the Commissioners is defined by them in paragraph 2 of the case as being:

"Whether the sums received by the appellant from the extraction and sale of timber from the said land for the relevant basis periods were sums received in the course of development of the said land into an oil palm plantation and were capital receipts and not income from a separate business of timber operators carried on by the appellant, and were, on the other hand, income chargeable to income tax, development tax and timber profit tax."

The Special Commissioners came to a finding that:

"We, the Special Commissioners of Income Tax, after hearing the witnesses who were called by appellant and after considering the submissions made on behalf of the appellant and the respondent, decide that the sums received from the extraction and sale of timber from the said land for the relevant basis periods were income chargeable to income tax, development tax and profits tax."

The Special Commissioners also found that:

"there were two separate and distinct activities, viz, the extraction and sale of timber from the said land and the development of the said land into an oil palm estate. Such extraction and sale of the said timber constituted the carrying on of a business of timber operators under section 4(a) of Income Tax, 1967. We therefore, decided that the sums received from the extraction and sale of the said timber for the relevant basis periods were income chargeable to income tax, development tax and timber profits tax."

The facts of the case as found by the Special Commissioners are as follows. The appellant company was incorporated in 1968. Its objects among other things were to carry on the business of planters and cultivators of and dealers in all kinds and descriptions of produce (Clause 1 of Memorandum of Association) and to carry on business as timber merchants, sawmill proprietors etc. (Clause 19 of Memorandum of Association). Either of these two objects or any of the objects specified in the Memorandum of Association may be pursued by the appellant as an independent object either alone or in conjunction with all or any one or more of the other objects.

In 1968 the Johor State Government was contemplating a scheme to alienate State land to the private sector for development. In August 1968 the news was published in the newspapers that the Government would alienate 42,000 acres of virgin land in the district of Kluang and Sungei Pangali on a 99 year lease for the scheme. Successful applicants would be given 7,000 acres for the development of oil palm. The applicants would be required to surrender 1,500 acres from the 7,000 acres when they are fully planted with oil palm to the Johor State Development Corporation. The State Development Corporation would realienate the 1,500 acres to small-holders.

The appellant was one of the successful applicants. It was informed of the approval by the State Government by way of notice dated November 30, 1968. The appellant was allotted a parcel of virgin jungle land described as Block 6 comprising an area of approximately 7,000 acres in the Mukim of Nyior in the district of Kluang, for development into oil palm plantation subject to payment of various charges and to certain terms and conditions are stipulated in the notice. As one of the terms and conditions was that the appellant would be given the right to extract timber from that land, the appellant was required to enter into an agreement with the State Government with regards to the extraction of timber from the land.

Following this the appellant entered into an agreement with the State Government on June 1, 1969. On January 3, 1970 the appellant entered into an agreement with Syarikat Kilang Papan Low Nam Hui Sdn. Bhd. to extract the timber from the land. On September 22, 1969 an area of approximately 50,000 acres which included Block 6 was de-gazetted as a forest reserve.

The appellant was given the logging licence in April, 1970 and commenced logging operation on July 20, 1970.

The Special Commissioners also found that during the relevant basis periods in respect of which assessment of income tax, timber profit tax and development tax were made only two blocks of 1,000 acres each were exploited. Each block was divided into sub-blocks of 250 acres each.

It is significant that the *modus operandi* for the development was controlled by the Forest Department. It was stipulated that 80% of the first sub-block of 250 acres each should be exploited before the appellant could move into the next sub-block and entry into the third sub-block would be allowed only after the whole of the sub-block and 80% of the second sub-block had been exploited. The exploitation of all the remaining sub-blocks would follow the same sequence.

The appellant cleared 1,000 acres in September 1971 and a second 1,000 acres in September, 1972. The delay was caused by floods, construction of bridges and access roads and the difficulties in obtaining right of way through a neighbouring estate and numerous kampongs. However the terms of the agreement of June 1, 1969 which contain the schedule of work was amended by mutual agreement between the developers, including the appellant, and the State Government following a meeting on June 26, 1971.

The appellant did not have any experience in timber marketing. It appointed Pan-Singapore Timber Enterprise Company of Singapore as its agents to find buyers. The appellant received the price of the sale less transport charges, export duties and related expenses. The Pan-Singapore Timber Enterprise Company was paid the sales commission.

The subscribers to the appellant's Memorandum and Articles of Association were Tan Kim Seng and Than Poh Yen. On March 18, 1969 these shares were transferred to Dato' Tsang Tak Chuen and Tan Ooi Kian by the issue of $829,998 shares of $1 each on August 30, 1969. The total shares of $830,000 were transferred to Low Nam Hui & Co. on December 3, 1972.

At the time the company shares were transferred to Low Nam Hui Company in December 1972 the first 2,000 acres had been logged but not cleared or ready for planting. The appellant had to incur substantial expenditure on further felling and clearing and on establishing an oil palm nursery. It was only after that that work on the oil palm plantation commenced in earnest. Up to the time when the hearing came before the Commissioners all except 300 acres of the land had been planted with oil palm. The appellant had also surrendered the 1,500 acres of oil palm to the State Government.

The Special Commissioners came to a finding that the appellant was carrying out two different activities. They concluded that the company was carrying out the activities of extracting and selling timber and developing the land into an oil palm estate.

It has been argued that the deciding order of the Special Commissioners is entirely based on findings of facts and as such the court cannot interfere with the decision made on such findings by the Special Commissioners. With respect I am of the opinion that it is open for the High Court to review the decision of the Special Commissioners, if the Special Commissioners:

1. misdirect themselves on the law; or
2. answer the wrong question; or
3. omit to answer a question which they ought to have answered; or
4. took into account factors which they ought not to have; or
5. reached a conclusion on facts which is not supported by the evidence before them; or
6. made a finding of facts which no reasonable person in the circumstances would have arrived at.

In the case of *M.Y.* v. *Comptroller of Inland Revenue*[1] the Federal Court rejected the contention

that the Special Commissioners was the final authority on conclusions of fact. Gill F.J. (as he then was) in delivering the judgment of the Court said:

"In dealing with the case stated the learned judge in the court below, from whose decision this appeal has been brought, took the view that as the Special Commissioners who had all the relevant material facts before them reviewed the facts as whole before arriving at their conclusion, it was not open to him to review such conclusion and he accordingly dismissed the appeal. I regret to say, with respect, I find myself unable to agree with him.... On the whole their conclusion could not properly be drawn from the evidence before them. In those circumstances it was open to the learned judge, as it is open to this court, to review the decision of the Special Commissioners."

Sharma J. in the case of *N.Y.F. Realty Sdn. Bhd.* v. *Comptroller of Inland Revenue*[2] expressed similar views. The learned judge said:

"Whether or not facts and evidence produced before the Special Commissioners lead to the conclusion that the taxpayer was or was not carrying on the business or trade within the meaning of the law depends on inferences from facts. The inference to be drawn from the acts and conduct of the taxpayer i.e. whether he carried on a trade or business is, in my view, a question of law.... Therefore even if the Special Commissioners do specifically state that the taxpayer was carrying on the business of a land jobber the court is entitled to enquire into the correctness of that conclusion by considering the same facts from which the Special Commissioners drew the inferences."

In the light of the above decision I am of the view that the High Court has power to interfere with inferences drawn by the Special Commissioners whether they be conclusions of fact or law.

The Special Commissioners came to the conclusion that the appellant was carrying out two different activities on several grounds. It would appear to me that the Special Commissioners were unduly influenced by the object clause of the appellant's Memorandum of Association which empowered the company to carry on the business of a timber merchant. With respect I am of the view that the relevant question for tax purposes is not what the taxpayer proposes to carry on but what he does actually carry on. (*Re Hydnland Investment Co. Ltd.*[3]). In *E.* v. *Comptroller of Inland Revenue*[4] Gill F.J. (as he then was) in delivering the judgment of the Federal Court had this to say:

"I need hardly add that in this case the clause in question is not the main or the only clause in relation to the objects of the company.... As there were other objects of the company, singling out one of them for the inference that the appellant intended to carry on business was to ignore the other object together...."

It is therefore clear that the object clauses in a company's Memorandum of Association themselves are not to be taken as conclusive proof as to the nature of business carried on by the taxpayer.

The Special Commissioners dealt with the appellant's application for the said land with a suggestion of a hidden motive contrary to what is clearly borne out by the facts. It is curious that the Special Commissioners regarded the appellant's application as an "ostensible" act. This conclusion is definitely against the evidence put before them. All the documentary evidence shows that the land was alienated to the applicant for the main purpose of development into an oil palm estate. That being so all other activities necessarily become incidental to the main activity of oil palm cultivation. The extraction of timber would and should be regarded as ancillary to the main object. There was cogent evidence before the Special Commissioners that the appellant had made preparations to get ready the oil palm seedlings for planting even whilst the land was being cleared. It is also shown that the main object was completed and 1,500 acres were surrendered to the State Government fully planted. This in truth was the basic aim of the Government to realienate the fully planted land to small holders. The Special Commissioners finding that the appellant was only "ostensibly" interested in oil palm cultivation is therefore not supported by facts.

The Special Commissioners placed heavy emphasis on the agreement entered into by the appellant and the State Government whereby the appellant was given the right to extract timber. I think too much emphasis should not have been given on this. It should be noted that the extraction of timber was actually a condition of the alienation. The extraction of timber is a prerequisite in the preparation for the cultivation of the land with oil palm. For otherwise how else could the land be planted with oil palm without first clearing the land of the timber standing on it.

The agreement entered into by the parties was to ensure that the extraction was done in orderly manner and that the Government would not lose its revenue from the timber on the land. The appellant was left with no choice but to fell and sell the timber. It stands to lose the land if it does not enter into the agreement and comply with the conditions in it.

It is also to be noted that the land was alienated to the appellant by way of qualified title. The standing timber therefore formed part of the land. The appellant had not only a proprietary interest in the land but it also had an interest in the standing timber. The licence to extract timber issued by the Forest Department is in compliance with the provision of section 45(2)(b) of the National Land Code which authorises the owner of the land to remove forest produce beyond the boundaries of the land. The appellant as the owner of the land must obtain a licence from the Forest Department for that purpose. It is therefore unreasonable to conclude that the appellant was carrying on a separate business of timber operators relying on the so-called right to extract timber.

The Special Commissioners appeared to have been greatly influenced by the preamble to the agreement of June 1, 1969 between the appellant and the State Government. The preamble uses the words "desirous of... exploiting timber thereon". It would seem that these words have the effect in the opinion of the Special Commissioners that the appellant was more interested in timber exploitation than in oil palm cultivation. The Special Commissioners formed an opinion that the exploitation of timber and the development of the said land were two different activities.

The language used by the parties to a document is not the determining factor. It is the duty of the court to see what in substance, and in truth, the bargain was and not to be blinded by some formula which the parties may have used. In *Henley* v. *Murray*[5] Evershed, M.R. said:

"... I quite agree that language which the parties may use, such as 'compensation for loss of office', is not the determining factor when one has to decide what in truth was the bargain, and that the duty of the court is to see what in sub-

stance, and in truth, the bargain was and not to be blinded by some formula which the parties may have used."

The Special Commissioners came to the conclusion that in exercising the right to extract timber from the said land for which the forest premium was paid, the appellant was engaged in a trade of exploiting of timber and not in activities in the course of development of the said land into an oil palm plantation. It is difficult to understand how this conclusion could have been arrived at. It is true that the appellant did pay $100 per acre as premium. But no where does it show that the appellant knew of the fact that $47 was for forest premium. In any event even if the appellant knew that the $47 was paid as premium for the forest produce it would still not afford any proof that the appellant was engaged in a trade of exploiting of timber.

The Special Commissioners also came to the conclusion that the timber extraction activities were very similar to those of a timber operator and they were consistent with the claim that there was an organised and systematic exploitation of timber. In my opinion there were no basis for the Special Commissioners to find that the activities of the appellant were very similar to those of a timber operator. The extensiveness of the organisation or activity are not grounds for them to arrive at the conclusion. In the case of *Commissioner of Taxes* v. *British Australian Wool Realization Association, Ltd.*[6] Lord Blanesburgh said:

"Upon the facts stated, any other conclusion would be tantamount to saying that a realisation such as that effected by the Association must be a trade because of the bringing into existence of a selling organisation made necessary only by reason of mere magnitude of the realization — a proposition not to be entertained."

The Privy Council held that notwithstanding the extensiveness of the taxpayer's organisation, the receipts resulted merely from the realisation of capital assets and therefore not taxable. The fact that the timber extraction was organised and systematic does not detract from the fact that what it did was merely realising a part of its capital asset and that the proceeds therefrom are capital receipts and not income receipts.

The Special Commissioners were influenced by the fact that most of the timber were extracted and sold and that a contractor and a selling agent were employed. The Special Commissioners should have considered also the fact that the appellant had no experience as a timber operator nor timber extraction and sale of timber. The appellant in my view extracted the timber in the best possible way to maximise the receipts. But that fact alone does not make the activity any less an activity of a landowner realising part of its capital asset. As Rowlatt J. said in *Rand* v. *Alberni Land Co. Ltd.*[7]:

"Now the company proceeded in a very enterprising way undoubtedly. It cleared the land and formed roads. It sold parts of it and kept some of the money and put it back into the land, and so on, and it gave a share in its capital to certain people who were instrumental in bringing a railway there.... I feel the force of what is said, that they were very enterprising. They did more than a lazy or a too conservative landowner would do. They were enterprising, but I do not think they did more than act as the machinery by which development and progressive sale could be carried out...."

For the same reason it cannot be said that the appellant had carried on a business merely because it undertook the clearance of the virgin land for the purpose of oil palm cultivation in a more intelligent way so that the disposal of its assets on the land in the form of standing timber would not be a waste disposal but saleable at market value. In my opinion the Special Commissioners erred in law in that they proceeded in their inquiry on the basis of ascertaining if the appellant was carrying on business as timber operators. They should have inquired whether the felling and sale of timber was realisation of a capital asset effected as incidental activity to the main activity of clearing the land for oil palm development or whether by doing so they were carrying on a business of felling and selling timber.

It is apparent to me that the Special Commissioners failed to consider legally whether the proceeds from the sale of timber constitute income. The object of the Act is to tax 'income'. The word 'income' is not defined in the main Act. However not every gain, profit or earnings of the taxpayer is 'income' for the purposes of tax. By section 4 of the main act only 'income' is taxable. Such income however must be in the nature of gains or profits depending upon the sources of the receipts enumerated in paragraphs (a) to (f) of the section. It is the duty of the Special Commissioners to look at the transaction in the light of whether the receipts by the appellant are capital in nature or income in nature. The Special Commissioners have completely ignored this approach. In *Van Den Berghs, Ltd.* v. *Clark*[8] Lord MacMillan said:

"My Lords, the problem of discriminating between an income receipt and a capital receipt and between an income disbursement and a capital disbursement is one which in recent years has frequently engaged your Lordship's attention. In general the distinction is well recognised and easily applied, but from time to time cases arise where the item lies on the borderline and the task of assigning it to income or to capital becomes one of much refinement, as the decisions show. The Income Tax Acts nowhere define 'income' any more than they define 'capital', they describe sources of income and prescribe methods of computing income, but what constitutes income they discreetly refrain from saying... Consequently it is to the decided cases that one must go in search of light."

The Special Commissioners failed to show clearly that the proceeds was 'income' of a type chargeable with tax and fitted into the relevant provisions. In law there is no room for presumption as regards to tax. In the case of *Cape Brady Case*[9] Rowlatt J. said:

"... in a taxing Act one has to look merely at what is clearly said. There is no room for any intentment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language."

In the circumstances of the facts as found by the Special Commissioners and drawing the reasonable inferences from them the extraction and sale of timber and the development of the land into oil palm were one activity for the purpose of tax. The sum received by the appellant from the extraction and sale of timber from the said land for the relevant basis periods were sums received in the course of development of the said land into an oil palm and therefore are not chargeable to income tax, development tax and timber profit tax.

The appeal is therefore allowed with costs.

Appeal allowed.

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